

## Westpac puts its 'trust' in securitisation

September saw the first international issue of mortgage-backed securities (MBS) secured on assets originated by the Australian bank Westpac Banking Corp (Westpac). With three domestic MBS issues earlier this year already in the bag, this latest offering takes Westpac's total funding from MBS issues in 1997 over the A\$2bn mark, and has established it as Australia's market leader in mortgage securitisation. Permjit Singh thinks that's not bad for a player in its first season in the mortgage securitisation market.

**T**he latest offering, Series 1997-4E WST Trust (the Trust), consists of US\$499m of class A MBS and US\$17.6m of class B MBS, secured on a pool of residential mortgages. The MBS will be issued by Westpac Securities Administration Ltd in its capacity as trustee under the Trust, and will be administered by The Mortgage Company Pty Ltd, a wholly owned subsidiary of Westpac. The key terms of the MBS are summarised below.

### The programme

Westpac's securitisation programme has been modelled around a master trust. This structure is analogous to a 'clothes-line' on which many individual trusts can be hung (attached), each of which holds discrete pools of assets that are funded by issues of MBS.

Sean Hogan, senior manager at Westpac Group Treasury and architect of the Euro-issue, notes: "A key feature of the trust structure is its tax and capital efficiency", making this a particularly attractive enti-

ty for securitisation. A master trust structure also exploits economies of scale, enabling Westpac to securitise a variety of consumer assets it has originated, under a common documentation set.

Kimberley Gire, head of group securitisation at Westpac Group Treasury, says that: "As well as cost savings, the master trust structure enabled us to bring the international issue to the market in six to eight weeks from the decision to securitise."

A relatively rapid response time is important to Westpac. "We expect to issue quarterly, subject to market conditions, and the master trust will facilitate that frequency," says Gire.

With A\$2bn already issued this year under its master trust, Westpac has become a market leader in the Australian MBS market. Gire attributes its success to: an ability to administer securitisation issues; an evolution of increasingly sophisticated securitisation structures (which began with a private placement, followed by public domestic issues and now an international offering incorporating interest rate and currency swaps); and a strong in-house securitisation team.

"We have also been fortunate with timing; changes to withholding tax regulations now enable issues to be made directly to investors," says Gire.

The latest issue realised Westpac's securitisation objectives of diversifying its investor base and type of funding instrument (and enhancing its return on capital). According to Thomas Dunn, vice-president at JP Morgan (co-lead manager in this deal), "interest in this MBS has been shown by financial institutions,

|         | Issued amount<br>US\$m | Credit rating<br>(S&P/Moody's) | Estimated average life<br>(years) | Margin over three-month<br>US\$ Libor (bp) | Issue price |
|---------|------------------------|--------------------------------|-----------------------------------|--|-------------|
| Class A | 499                    | AAA/Aaa                        | 3.2-4.1                           | TBA  | Par         |
| Class B | 17.6                   | AA-/NR                         | 5.6-7.1                           | TBA  | Par         |

NR = not rated; estimated average life is based on an assumed constant principal payment rate of 20%-25%, including scheduled repayments and unscheduled prepayments.



supranationals, leveraged funds and corporates and, in terms of location, the UK, Benelux, Ireland and, to a lesser degree, the Far East and Middle East".

Gire and Dunn argue that investors have principally been attracted to the name – in that Westpac is a major mortgage originator – as well as the credit quality of the collateral for the MBS, and Westpac's mortgage processing capability.

## The assets

The asset pool providing security to the Trust is of a high credit quality typical of the pools supporting the other trusts (no losses have been recorded on existing public WST issues). It consists of 7,000 loans, with an average size of A\$106,000 (consistent with the market average). All are secured by a registered first-ranking mortgage over residential property. A full 76% are owner-occupied and 24% are for investment purposes.

The pool has an average loan-to-value (LTV) ratio of 66%, as against the market average of 67%, and is considered to be geographically relatively well diversified. Some 15% of the pool has an implied seasoning profile of around five years at least, making it relatively more mature than the other master trusts' pools and so less likely to experience loan default.

Primary mortgage insurance is provided on all loans with an LTV ratio over 80%. All loans with an LTV equal to or below 80% have also been insured (for 100% of the loan), by the Housing Loan Insurance Corp (HLIC), and up to a total loss amount of A\$37m. HLIC is owned and guaranteed by the Commonwealth of Australia. The primary mortgage insurance providers are rated AA– by Standard & Poor's; HLIC is rated Aaa by Moody's.

## The risks

Australia's residential mortgages have fared significantly better in credit terms than, for example, the US; and its mort-

gage insurance sector has surpassed those of the US and UK, in terms of performance and frequency of claims.

The high credit quality of Australia's residential mortgages has been attributed to tight underwriting criteria; an ability to pursue mortgagors for credit losses (even in cases of negative equity); economic diversity within Australia's five capital cities (which account for over 60% of the population); households' debt-service payment and indebtedness being moderate by international standards; a steady appreciation in property values (which has given mortgagors an incentive to continue their payments); and mortgage lenders typically insuring all mortgages with an LTV over 80%.

Principal and interest on the MBS is payable quarterly in arrears. Reinvestment risk, is mitigated by investment income from mortgage prepayments in authorised investments, using mortgage prepayments to meet interest shortfalls, and drawing on a A\$25m liquidity facility provided by Westpac.

Where mortgage prepayments have been used to meet interest shortfalls, they will be replenished from excess available income, as it arises, in subsequent periods.

The pool comprises residential mortgages that are all denominated in Australian dollars. Most pay a floating rate of interest, which is set at the discretion of Westpac. The remainder pay a fixed rate, which lasts for up to five years. Over 90% of the mortgages periodically repay (amortise) principal, in addition to interest, with the remainder converting to this basis after the interest-only period has ended.

As indicated above, the MBS pay principal and interest in US dollars. The interest rate is based on a variable three-month US dollar Libor interest rate. To mitigate the resulting basis risk and currency risk, the issuer will enter into a number of swap transactions.

Under a currency swap provided by AAA rated Morgan Guaranty Trust Company of New York (MGT), the issuer will pay to MGT, quarterly, Australian dollar mortgage principal prepayments; and will receive an equivalent amount in US dollars for payment to the MBS investors.

At the same time, the issuer will make Australian dollar floating-rate payments to MGT, in exchange for US dollar floating-rate amounts that are equivalent to interest payable on the MBS. Basis risk will be mitigated by three interest-rate swaps between the issuer and AA– rated Westpac.

Under a variable-rate basis swap, the issuer will pay to Westpac the weighted average of the variable rate paid on the pool's variable-rate mortgages, and fixed-rate mortgages whose rate is fixed for the first 12 months. The issuer will receive from Westpac the Bank Bill Rate<sup>1</sup> plus a fixed margin. Under two fixed-rate basis swaps, the issuer will pay to Westpac the weighted average fixed rate paid on all other fixed-rate mortgages, and receive from Westpac the Bank Bill Rate plus a fixed margin.

Two fixed-rate swaps have been used to distinguish fixed-rate mortgages which have arisen through conversion from a variable-rate mortgage from those which were at a fixed rate at a specific date.

One of Westpac's strategic objectives is to enhance the management of its capital resources and improve return on capital to its shareholders, both of which are being realised by its programmes of asset securitisation and share repurchase.

Westpac has also sought to implement securitisation in response to the competitive threat posed by emerging low-cost mortgage originators in the domestic market. By securitising its low-margin mortgages, it will also be addressing the tightening seen in interest-rate spreads in the residential mortgage sector.

<sup>1</sup> This is an average market rate for buying and selling bills of exchange which have a tenor of 90 days.